CHECK AGAINST DELIVERY

The Economic and Fiscal Update

A Presentation by
The Honourable Paul Martin, P.C., M.P.

To the House of Commons
Standing Committee on Finance

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Mr. Chairman,

In previous appearances before this Committee, we outlined the extraordinary fiscal and economic challenges faced by our country.

The purpose of my presentation today and the document I am tabling is to provide an update on how we are meeting these challenges – and the work that still lies ahead.

Before doing so, however, let me reiterate what our paramount objective was when we formed the government in November 1993.

We have talked about the need to clean up the nation's finances – and the requirement to get government right.

But this is only a means to a much greater end – a country whose economy is growing, a future where the prospects for more jobs are much brighter, and a society of fairness and compassion.

From the outset, this government has pursued an agenda that focuses on the three tasks we believe are the key to the achievement of our goals.

The first is the absolute necessity to get the foundation right – to restore the confidence of Canadians in their economy, of investors in our country.

The second task is the parallel obligation to make our great social programs sustainable over the long run.

And finally, the third task is to provide Canadians with the support they require to take advantage of the modern economy – fulfilling the responsibility, in particular, of giving our young people the best opportunities to succeed that we can.

We have always believed these challenges are linked and that meeting them, therefore, requires acting on all three fronts together.

And that is what we are doing.

Today, I believe we can say that success is much closer than we had hoped, far less distant than many had feared.

Let me begin with the fiscal challenge.

Only three years ago, the financial health of our country was deteriorating rapidly.

Consistently, for two decades, governments had been spending much more than they brought in.

Consistently, they had been papering over the problem – borrowing here, borrowing abroad – always borrowing against the future.

As a result, the nation's finances were being strangled in the ever-tightening grip of compound interest.

The deficit stood at $42 billion and it was destined to rise even further.

The federal government's debt-to-GDP ratio – the ratio of what we owe to what we produce – had ballooned from 19 per cent in the mid 1970s to over 70 per cent in 1993 and climbing.

As a result, the markets were demanding a very large risk premium on interest rates, a huge cost when tacked on to a debt level that was way out of line.

In short, by 1993, our economic sovereignty had been undermined.

We had become hostage to every foreign market whim and whisper.

Now, there is a wide range of opinion as to how we got into this mess.

But important as that debate is, the point is, we were in one, and we knew we absolutely had to get out.

That we had to take dramatic action was not a question of ideology.

It was simply that a terrible price would be paid if we did nothing – a price measured in high interest rates, lost investment, lost income, lost jobs.

Furthermore, we knew our goal had to be permanent fiscal recovery – not a temporary quick fix.

We knew that if we did not act to restore fiscal health, literally nothing else we might do to boost jobs, to preserve our social programs, would work.

We also knew that a necessary condition for restoring a government's fiscal health was to create a climate conducive to lowering interest rates, and that the only way for the government to do that was to restore market confidence in the way we manage our business.

Our objective, therefore, was clear: to balance the books.

Our pace: measured, deliberate, and responsible.

Our strategy: two tracks – economic growth and spending cuts.

The results? In 1993-94, the deficit represented about 6 per cent of GDP.

In 1994-95, the deficit came in at $37.5 billion – or 5 per cent of GDP – $4.5 billion below the previous year.

Today, we are releasing the *Annual Financial Report* for the 1995-96 fiscal year. It shows that the deficit was brought down further to $28.6 billion.

This is almost $9 billion less than the previous year and represents by far the largest single year-over-year decline in four decades.

Mr. Chairman, the deficit result for last year is $4.1 billion below our target of $32.7 billion.

We have always said that our targets were not the best we would achieve, but the minimum.

Why have we done better than target? One major reason is that government spending was $1.7 billion lower than we had projected.

In fact, program spending in 1995-96 declined in absolute terms for the third consecutive year.

It was $6.7 billion below the previous year's level and $10.6 billion below the peak year, 1992-93.

The new system we have put in place to rein in spending – a system that forces trade-offs, assesses risk and controls costs – is clearly working.

In addition, the Contingency Reserve of $2.5 billion was not touched.

It was established to cover the unexpected and we said from the beginning that if it was not required it would not be spent.

Mr. Chairman, it was not required and it was not spent.

Looking ahead, the question obviously arises – what about the year underway?

The answer is – we will hit our target for 1996-97 – a deficit of $24.3 billion or 3 per cent of GDP.

We may indeed better it.

It is expected that lower revenues, due to lower than anticipated nominal income growth, will be offset by lower than expected short-term interest rates.

We also believe that the deficit target for 1997-98 – $17 billion, which works out to 2 per cent of GDP – will be achieved as a result of the continuing expenditure cuts made in our previous budgets.

Mr. Chairman, it is appropriate to ask what the pay-off has been for these efforts to restore fiscal health. In the 1995 budget we pointed out the great problem of escalating interest rates.

We attributed this escalation partly to global factors on the one hand, but particularly to a lack of discipline in domestic economic management.

Since then – in no small way as a result of the actions taken by the federal and provincial governments – the interest rate picture has improved dramatically.

As recently as early 1995, short-term interest rates in Canada were almost 2½ percentage points *above* American rates.

Today, Canadian short-term rates are about 1½ percentage points *lower* than the U.S.

Indeed, Canadian rates are lower than U.S. rates up to a term of *five years.*

The fact is, short-term rates have come down by more than 4½ percentage points since early last year.

This decline will put more Canadians back to work and more money in their pockets than could any conceivable government program or tax reduction.

In fact, 17 interest rate reductions over the last 17 months. What does this mean to Canadians?

Well, to a consumer who buys a new $15,000 car next week, it means a saving of almost $500 a year.

To a small business person with a $1 million loan, it means more than $28,000 in yearly savings.

To someone renewing a one-year $100,000 mortgage, it means a saving of over $3,000 annually.

It should also be noted that the drop in rates has helped the provinces meet their deficit targets.

Between January of last year and June of this year, for instance, the provinces saved $1.3 billion in interest charges on their debt.

As three examples, Alberta saw its interest charges drop by $165 million, Ontario saved $325 million, and Quebec realized savings of $625 million as a result of reductions in interest rates.

It is very clear that interest rates count, and count importantly.

Looking ahead, it is in their very nature that they go up and down.

No one country can control the global conditions that make that happen. Not Canada and not even the U.S., Germany or Japan.

But what we can control are *Canadian* conditions – making sure our economic fundamentals are such as to minimize any potential rise.

This is what we have done and this is what we will continue to do.

Now, interest rates are not the only numbers which confirm the dramatic turnaround in Canada's economic condition.

Inflation remains firmly under control.

Our competitiveness vis-à-vis the United States is the best in the 46 years that data have been available.

Our merchandise trade balance, exports over imports, is running at its highest annual surplus ever.

Canadian tourism has been given a strong boost – with the balance in the travel account improving significantly.

As a result of these factors, our current account deficit – which measures the difference between the payments we make to foreigners and the payments we receive from them – has improved significantly.

In fact, in the second quarter of this year, Canada ran its first current account *surplus* in 12 years.

This means that our net foreign indebtedness actually fell.

The bottom line is that the benefits of sound monetary and sound fiscal policy are now being joined.

Mr. Chairman, it is clear that Canada is beginning to enjoy the fruits of its labour; the numbers are better than they have been for some time.

The question is – are we ready to declare victory? The answer is no, not yet.

And for this reason, those who would suggest we now alter course – by bringing in a broad-based tax cut – are wrong.

Make no mistake.

Offering a broad-based tax cut is certainly tempting.

And, as hardworking Canadians everywhere know, the tax burden is higher than any of us would like it to be.

But, should the government consider a broad-based tax cut when the fiscal challenge is not fully met? No.

That would be simply irresponsible.

Consider the example I described earlier where a car buyer currently saves $500 annually as a result of interest rate reductions since early last year.

For the government to provide equivalent savings to the average Canadian taxpayer would require a personal income tax cut of over 11 per cent and would cost between $7 and $8 billion.

One choice would be to borrow it, to let the debt pile up by $7 billion plus interest every year.

What would that mean?

It would mean losing the financial credibility Canada has been able to re-establish.

It would mean, as a result, higher interest rates for Canadians.

And what would be the consequences of this? Goods not purchased, investments not made – and jobs not created.

We do not believe that Canadians want their national government to expose them to this risk.

Another choice to pay for a tax cut would be to reduce government programs by a further $7 billion.

Put this in perspective.

$7 billion is more than half the cash component that we will transfer to the provinces next year to support health care and other social programs.

It exceeds the federal government's total annual contribution to R&D.

It's more than 25 per cent of the current cost of Old Age Security and the GIS.

By 1998-99, we will have cut total program spending by 14 per cent from its peak level in 1992-93.

This will represent a $17.1 billion reduction.

Now, certainly more savings are possible and certainly we will continue to look for them.

But having been through this process, and knowing the implications, let me tell you that finding another $7 billion would impose a staggering burden on Canadians.

Those who propose broad-based *tax* cuts never tell people which major *program* cuts would be required.

But as a matter of simple honesty, they have a responsibility to do so.

We believe the time will come when the government will be in the position to consider a broad-based tax cut. But it's not now.

However, on the other hand, it is feasible and desirable to use the tax system in a much more targeted way, reallocating *within* the revenue system, making it fairer, focusing on the specific needs of the disadvantaged and the fostering of jobs and economic growth.

In fact, that is exactly what we have been doing.

For example, eligibility for the child care expense deduction has been broadened.

Tax credits for those who take care of adult relatives with disabilities have been increased, as have tax credits that support the education of our young people.

The tax treatment of charitable donations has been improved.

Delivered through the tax system, the Working Income Supplement, which assists working parents with low incomes, was doubled in the last budget, providing $250 million in extra assistance each year to some 700,000 low-income working families.

And, as part of our effort to reduce payroll taxes as much as we can, our first act on taking office was to prevent EI premium rates from rising to $3.30.

Subsequently, the premium rate was reduced from $3.07 in 1994, to $2.95 in 1996.

We have also reduced the maximum earning base on which the premium rates are applied.

As a result of our efforts, workers and employers will save $1.8 billion in employment insurance costs this year and even more in the years to come.

Our bottom-line: targeted tax changes, certainly.

Broad tax reductions, yes – but only when the country can afford it.

Mr. Chairman, just as there are those who would alter course by slowing progress on the deficit, there are those who would alter course by seeking to eliminate it virtually in one fell swoop.

The question – is it time to accelerate the pace we have adopted from the beginning?

Again, we believe the answer is no.

We have always said our pace had to be measured – that a mad dash to zero was not on.

The fact is slash and burn budgets carry with them the seeds of their own destruction.

They would leave too many Canadians out in the cold – and that is something we will never agree to do.

We refuse to back away from the need to make the key investments that will spur growth and the creation of jobs and preserve health care and the social underpinnings of the nation.

And so, we will maintain our pace. We will keep on course – firmly, forcefully – an approach that has been virtually unprecedented in the results it has secured.

Therefore, consistent with our practice of two-year rolling targets, we are announcing today that the deficit target for 1998-99 is $9 billion, or about 1 per cent of GDP.

This target will be achieved by continuing the implementation of the structural changes set in motion by our 1994, 1995 and 1996 budgets.

This means that over five years, we will have brought the deficit down by $33 billion – a reduction of almost *80 per cent.*

And, we will have done this by focusing primarily on spending cuts, not tax increases.

Mr. Chairman, the deficit target announced today is important.

But what is even more important is what it means in terms of our need to borrow new money and where it places us in relationship to other countries.

Today's announcement means that in 1998-99, the federal government will not be borrowing any new money in the markets. New borrowing requirements will be *eliminated*. They will be *zero*.

The federal government will no longer have to borrow new money to pay for its interest charges; it will no longer be borrowing in the markets to pay for its ongoing programs.

As far as the rest of the world is concerned, new borrowing requirements are the measure most countries – the United States, the United Kingdom, Italy, France and Germany, for example – use to measure their fiscal health.

Borrowing requirements are also similar to the national accounts measure of deficits used by the OECD to make international comparisons.

The year prior to this government taking office, on a borrowing requirements basis, Canada had the worst record of any G-7 country except for Italy.

In 1997, by this measure, we will have the best fiscal health of any G-7 country.

Furthermore, the deficit target we have established today will ensure that the debt-to-GDP ratio will continue to decline.

This means we will have confirmed a new trend in which the growth of our economy finally exceeds the growth of our debt.

It means that, over time, our debt will become more and more manageable.

Our commitment and our course is to make this trend irreversible and irrevocable.

An improving debt-to-GDP ratio means an improving economy.

It means that a smaller portion of each revenue dollar will have to go to pay interest on the debt.

It means more consumer spending, more investment – greater economic growth.

It means more jobs.

Thus far, we have talked a lot about budget numbers.

But this is only one part of the picture.

Canadians look to their government to be more than a keeper of good books.

They want it to safeguard a caring society.

They want the social programs that have provided security and equality of opportunity to be there for them into the future.

The social program challenge demands going well beyond making the short-term numbers add up.

It demands a longer view and a broader horizon, *planning forward* into the next century.

In effect, it requires what few other countries have done – looking at changing demographics, ensuring not only that our fiscal health is sustainable but that our social safety net is as well.

Are we meeting this challenge? We believe that we are.

We have acted to ensure that federal support for health care, social assistance and post-secondary education is secure.

At the outset, in order to get our fiscal house in order, reductions in transfers to the provinces were necessary because they represented well over 20 per cent of our program spending.

However, today, with the new Canada Health and Social Transfer, a sustainable, stable and predictable five-year framework is now in place.

Under the CHST, we have established a floor below which the cash portion of the transfer will not be allowed to fall, and we have put in place a formula that will allow the overall transfer to grow in the future.

Next, we are pursuing an agreement with the provinces, as joint stewards of the Canada Pension Plan, to ensure that the CPP will be put on a sound financial footing – and done in a way that is sustainable, affordable and fair.

Furthermore, we are reforming the second pillar of the pension system – Old Age Security and the Guaranteed Income Supplement.

Legislation to implement a new Seniors Benefit will be introduced soon, to take effect in the year 2001.

The Seniors Benefit will make the pension system sustainable, while increasing help for those most in need.

Benefit cheques will not be reduced for current seniors and near seniors.

Indeed, those who receive GIS and the Spouse's Allowance will see their pensions increased by $120 per year.

Mr. Chairman, this is indeed a reform of which Canadians can be very proud.

Let me now turn to the third leg of our strategy: making the modern economy work for Canadians.

In terms of the numbers on job creation, no one can be satisfied.

But the fact is that our economy is going through a period of transition in which stronger private sector job activity has been somewhat overshadowed by job losses in the public sector – which represents about 15 per cent of total employment.

Ultimately, however, the public sector job losses will come to an end, and it is the private sector job creation figures that will count.

And here, the picture is much brighter.

For instance, since we have taken office, over ¾ of a million new jobs have been created by Canadian companies – 220,000 since last November alone.

Furthermore, there is every reason to believe that the state of the economy will continue to improve in the period that lies ahead.

Private sector forecasters expect the Canadian economy to grow at an annual rate of almost 4 per cent for the second half of this year. They also expect this momentum to carry on into 1997.

The International Monetary Fund agrees with this assessment, and says the Canadian economy will grow faster than any other G-7 country next year.

The IMF and Canadian forecasters all attribute this positive outlook to the reduction in our interest rates as well as our improved competitiveness – a pay-off from our policies of getting deficits under control and low inflation.

The strengthening economic outlook is already showing up in the data. Real growth in the economy was up 0.5 per cent in July alone.

The housing sector, one of the most interest-sensitive, is recovering strongly with resales and new starts up substantially over last year.

In addition, since the beginning of this year, business confidence has strengthened, and investment intentions have been revised up significantly.

All of this is good news for jobs.

But it is not good enough.

We have made considerable progress in establishing the preconditions for growth – low inflation, low interest rates.

But we believe the role of government in supporting job creation goes well beyond that.

Indeed this is where we differ fundamentally with those whose perspective on the role of government is apparently to make it disappear.

In particular we believe government has a responsibility to help Canadians adjust to the challenge of the modern economy.

The context for this challenge? Unprecedented globalization, rapid technological change, instantaneous capital flows, high speed communications.

It's a context we cannot change. Nor should we try, for it presents tremendous opportunities for our country, and for individual Canadians.

That being said however, behind these opportunities as well is a human reality that, for other Canadians, is far more sobering – one reflected in the unemployment picture that endures.

Now, in dealing with the problem of adjustment, some have said that government should leave it to the private sector alone and focus solely on getting its own house in order. We do not agree.

Our response was provided two years ago before this Committee, when we put forward a plan – *A New Framework for Economic Policy* – a guide as to how we believe government can contribute to a growing, more productive country.

Let there be no doubt. Creating a healthy fiscal and monetary climate is absolutely essential to achieving everything else.

However, getting the fundamentals right, by itself, is *not* enough.

It's only the first stage.

Before coming into government, my whole working life was spent in the private sector and I believe very much in its dynamism and its creativity.

But let me tell you, there are things business and the markets can't and won't do.

The private sector can't succeed in providing universal health care.

Markets can't provide decent pensions for all who need them.

Business doesn't do enough basic research.

The private sector by itself is not able to do all that it takes to promote trade.

And markets do not provide enough Canadians with the training they need to succeed.

In this context, the role of government must be to ensure that the expanding economy is large enough to accommodate everyone's needs and ambitions.

The fact is that the evolving economy, while benefiting many, can also cause jobs to be lost – in some industries, for the short term, in others for the long haul.

For instance, it is of little solace to the 55 year old machinist who has lost his job to know that technology or trade is creating jobs elsewhere – for someone else, somewhere else, with different skills or qualifications.

The question is how do we respond to this reality? There is no quick fix, no miracle cure.

The responsibility of government is clear.

It is to do all that it can to stand by those who are having difficulty adjusting to the changing economy on the one hand, and on the other, it is to ensure that each generation of Canadians is equipped to take advantage of the opportunities it presents.

This government's point of departure is the fact that Canadian success, in a world of growing trade and evolving technology, is not accidental, nor is it founded on low wages.

It does not lie in some race to the bottom.

It is based on a race to the top.

What we have to do is to develop new strategies of action that are not founded on the old ways of throwing money at problems – an approach we can't afford, and one which we now know, simply does not work.

Our strategy must lie in continuing to strengthen the strategic advantages we have – innovation, trade, our youth and their skills.

In terms of government spending, our focus must be on *reallocation*, concentrating the limited resources we have where their impact will be the greatest.

What do we need? *Leverage*, using seed money in ways that will bring others on board – initiatives where one dollar of funding can trigger many more dollars worth of action.

No government today can go it alone.

All governments must work in *partnership*.

This is true of the public-private sector partnership.

It is true of the partnership needed between governments.

Rather than fretting only about the division of powers, we should all be focused more on the *sharing of responsibility*.

It is time to rediscover the virtues of partnership and innovation.

It is those habits, not profligate spending, that built this great country.

There *is* a reality called the national interest.

Canadians expect us – and all governments owe it to them – to act accordingly.

The past several years have been extraordinarily difficult for Canada and for Canadians.

Fiscal irresponsibility sent interest rates sky-high.

The dysfunctional relationship between monetary policy and fiscal performance helped make the last recession long and deep.

Free trade and globalization have forced a painful process of adjustment on the whole country.

Among those who are without jobs, there has been despair.

And among those who have jobs, there has been fear.

But today, it is possible to say we are emerging from these shadows.

What our three budgets have done is to begin the process of restoring *policy sovereignty* to Canada.

Giving us the room, the capacity to make new choices – freed from the need to ever have to look back over our shoulder again.

Cleaning up the nation's balance sheet need not paralyze the nation's government.

What is required is the *will* to reallocate scarce financial resources, to identify new approaches that can be effective in helping Canadians today, without borrowing from Canadians tomorrow.

That, after all, is what governments used to do before they substituted money for solid thinking.

The purpose of our fiscal strategy is to restore freedom of action to Canada.

And we will not rest until the task is done.

The transition is not easy, but it is being made.

With forbearance and fortitude, Canadians, from coast to coast, have recognized and responded to the need for fundamental change.

Provincial governments of all political stripes, each in their own way, are part of a broad common effort to put our economic house in order.

If we are finally turning the corner, it is not because of any one of us alone; it is because we are doing it *together.*

No one should doubt that Canada will stay the course and that history will record this period as a pivotal point in the growth of our nation.

A time when we dealt decisively with the problems we inherited from the past, strengthened thereby to prepare the way for the future.

If we are confirming today that we will not let up, it is because we know how great the distance is we have travelled.

And if we are redoubling our resolve to go further, it is because we know how much brighter the future will be if we persevere.

I look forward to a discussion with this Committee as to how we can continue, and complete, this great journey together.